

Physician Practice Patterns: Impacting the Value of an Organization

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Physician's actions are the largest factor impacting the value of a healthcare organization. According to the Center for Medicare & Medicaid Services National Health Expenditures Accounts, U.S. health care spending growth accelerated slightly in 2006, increasing 6.7 percent compared to 6.5 percent in 2005. Total health expenditures reached \$2.1 trillion, which translates to \$7,026 per person or 16 percent of the nation's Gross Domestic Product. Of total health expenditures in 2006, \$660.2 billion are attributed to professional services. There are two types of revenue generating fees by healthcare organizations, technical fees and professional fees. Technical revenues are derived from reimbursement levels related to the facility, equipment, supplies, other operating expenses, and capital costs associated with the provision of care. Professional revenues are those revenues generated by the physician's professional fees. Together, the two revenue sources are known as "global fees".

Physician's actions are largely responsible for the revenue generated by healthcare organizations as physicians decide what treatment is needed for patients, the number of patients seen, and they perform the specialized procedures needed. Physician's actions largely generate technical revenues, thus their practice patterns ultimately impact the risk and cash flow of the organization. An organization whose revenues are attributed to a single or small number of physicians may be at a higher risk of experiencing a major loss of revenue due to the loss of a physician's services, thereby possibly leading to an overvaluation due to a significant loss of the entity's intangible asset value if this risk is overlooked. Larger organizations in which revenues are generated more equally among multiple physicians have less of a risk or loss of revenues due to the loss of a physician's services.

The physician-factor risk of a large healthcare organization compared to that of a single specialty practice is very different. Due to the difference in the underlying risk/reward relationship, the valuation analyst should use measurements specific to the organization being valued in deriving an opinion of value. To use measurements which are not specific to the organization would lead to an overstatement or understatement of value.

In order to perform a valuation on a healthcare organization, the first step is to understand how the "physician factor" impacts the volume of patients in an organization by answering the following questions:

- Does a physician dictate volume in a particular entity?
- Which physicians are primarily responsible for the current patient volume?
- Are there any physicians that represent a significant percentage of the volume?
- What is the age and expected remaining professional practice term of each physician?
- What competition exists for the subject entity in the immediate service area?
- Which key physicians might have compelling reasons to leave the subject entity and what might these reasons be?
- Are there any barriers to exit or entry that would deter a departing physician from competing with the entity?
- What capital costs are associated with the development of a new business?

Other Factors influencing the value of a healthcare organization are size, fragmentation, aging population and healthcare cost containment trends, and the healthcare regulatory environment. A qualified valuation analyst can help you determine the value of your healthcare practice and not overlook important factors and the risk these factors pose on the entity.

For assistance with a medical practice valuation, please contact Michelle Roth at LMF Valuation & Consulting, LLC. (210) 232-9961.